

**The German Banking System -  
System of the Future?**

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## THE GERMAN BANKING SYSTEM — SYSTEM OF THE FUTURE?

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### 1. INTRODUCTION

In early 1991 the United States Treasury Department of the Bush Administration recommended in its proposal for "Modernizing The Financial System"<sup>1</sup> that, in addition to other remarkable breaks with the traditional United States financial Services framework, the current bank holding Company structure be replaced with a new financial services holding company that would reward banks with the ability to engage in a broad new range of financial activities through separate affiliates, including full-service securities, insurance, and mutual fund activities.<sup>2</sup> The Treasury Department pointed out that commercial banking and investment banking are complementary services and that the Glass-Steagall Separation was unnecessary.<sup>3</sup> The Treasury Department gave many reasons for the need for financial modernization and why such a modernized system would work better. As an example that demonstrates the advantages of the system proposed by the Treasury Department, the proposal pointed to the German banks and called the German model of a universal banking system the most liberal banking system in the world.<sup>4</sup> —What makes the German universal banking system so unique and desirable? The following outline of the history and the current structure of the German banking system is intended to give readers a background to determine whether the German banking system could be a model for the system of the future.

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1. U.S. TREAS. DEP'T, MODERNIZING THE FINANCIAL SYSTEMS: RECOMMENDATIONS FOR SAFER, MORE COMPETITIVE BANKS 54-61 (1991) [hereinafter Treasury Dep't Recommendations]. The Treasury Department Recommendations provide an analysis of the development of the United States financial services industry. *Id.* at XVIII-1 to XVIII-38.

2. *Id.* at XVIII.

3. *Id.* at XVIII-13. But see Don More, Note, *The Virtues of Glass-Steagall: An Argument Against Legislative Repeal*, 1991 COLUM. BUS. L. REV. 433 [hereinafter More, Note].

4. Treasury Dep't Recommendations, *supra* note 1, at XVIII-29.

## II. HISTORICAL DEVELOPMENT OF THE GERMAN BANKING SYSTEM

The roots of the present universal banking system in Germany can be found in the late eighteenth century and the beginning of the nineteenth century when the banking business was run largely by private bankers like Bethmann, Rothschild, and Bleichröder.<sup>5</sup> These private bankers were engaged in the deposit and credit business and underwrote securities of sovereign issuers.<sup>6</sup> Banks in the legal form of corporations were formed in the middle of the nineteenth century and operated from the beginning as universal banks.<sup>7</sup> Although the banking crisis of 1931 and the years after 1945 were critical times for the German banks, the universal banking system survived. Unlike the United States, Germany did not enact a Glass-Steagall Act<sup>8</sup> in response to the banking crisis of 1931. The United States' influence after the Second World War led only to the creation of a central bank system comparable to the Federal Reserve System, but, other than in Japan, the United States did not insist on a Separation of commercial banking from investment banking.<sup>9</sup>

After the Second World War, the Western Allied Powers closed the German central bank, the *Reichsbank*, which had been established in the year 1876, and created eleven state central banks (*Landeszentralbanken*) — one central bank for each state. In 1948, as a first step towards a new federal central bank, the Bank of the German States (*Bank deutscher Länder*) was created as a central bank for the state central banks for the occupation zones of the United States, France, and Great Brit-

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5. BANKIERS SIND AUCH MENSCHEN, 225 JAHRE BANKHAUS GEBRÜDER BETHMANN (V. Bethmann ed.). See *Bankgeschichte in BANK-LEXIKON* 291-315 (Karlheinz Müssing et al. eds., 10th ed. 1988) [hereinafter BANK-LEXIKON]; Hans Pohl, *Das deutsche Bankwesen (1806-1848)*, in 2 DEUTSCHE BANKENGESCHICHTE 18-42 (1982) [hereinafter H. Pohl, *Das Deutsche Bankwesen (1806-1848)*]; Michael Hoefflich, *Historical Perspectives on Sovereign Lending*, in SOVEREIGN LENDING: MANAGING LEGAL RISKS 21-27 (Michael Gruson & Ralph Reiner eds., 1984).

6. H. Pohl, *Das deutsche Bankwesen (1806-1848)*, *supra* note 5, at 21, 23-26.

7. H. Pohl, *Das deutsche Bankwesen (1806-1848)*, *supra* note 5, at 119-23; Manfred Pohl, *Die Entwicklung der deutschen Bankwesens zwischen 1848 und 1870*, in 2 DEUTSCHE BANKENGESCHICHTE 171-73 (1982).

8. The Glass-Steagall Act is set forth in various sections of the Banking Act of 1933; See, e.g., 12 U.S.C. §§ 24, 78, 278 & 377 (1988).

9. See the discussion of the Dodge Plan for the reorganization of the German banking system which proposed a separation of commercial banks and investment banks in Manfred Pohl, *Die Entwicklung des privaten Bankwesens nach 1945*; in 3 DEUTSCHE BANKENGESCHICHTE 225-26 (1983) [hereinafter M. Pohl, *Entwicklung*].

ain.<sup>10</sup> Finally, in 1957 the Bank of the German States and the state central banks were replaced by the German Federal Bank (Deutsche *Bundesbank*). The German Federal Bank is the German central bank and a bank of issue, and its **main functions** are to **guarantee** the stability of the **monetary** System, to regulate the circulation of money, and to safeguard the supply of **credits** for the economy. The German Federal Bank has its central **ad-**ministration in Frankfurt. It **has** nine main **offices**, which are still **called state** central banks (Landeszentralbanken). These **state** central banks are not separate entities, **as** they had been before 1957, but **branches** of the German Federal Bank.

Parallel to this development, a process of dissolution and re-creation of the **former** three large commercial banks took **place**. After the **Second** World War, the Western Allied Powers dissolved the three large banking corporations — Deutsche Bank AG, Dresdner Bank AG, and Commerzbank AG — and permitted the **creation** of thirty successor banking institutions. In 1952 the **thirty** banking institutions were recombined into three successor institutions for **each** of the **former** three large banks, and in 1957 the **former** Deutsche Bank, Dresdner Bank, and Commerzbank were **reconstituted**.<sup>11</sup>

### III. BANKING IN GERMANY TO D A Y

The banking industry in **Germany** is composed of a variety of public and private **credit** institutions. Although the kinds of activities permitted to **each** category of **credit** institutions are not limited, **certain distinctions** in the typical range of customers or **transactions** still exist. The different **credit** institutions are: (1) the private **sector** commercial banks (*private* Geschäftsbanken); (2) the savings banks (Sparkassen) and their central institutions (*Landesbanken und Girozentralen*);<sup>12</sup> and, (3) the industrial and agricultural **credit** Co-operatives (*Volksbanken and Raiffeisenbanken*), their regional institutions (*Genossenschaftliche Zentralbanken*), and their central institution (*Deutsche Genossenschaftsbank*).<sup>13</sup>

The savings **banks**, which formerly had their **focal point** in

10. Id. at 226-31.

11. For **details**, see *id.* at 231-41.

12. **Since** the activities of **the savings banks are** governed by **state law**, their **permitted scope** of activities might slightly **vary** from **state to state**. All **are**, however, universal banks.

13. See M. Pohl, *Entwicklung*, *supra* note 9, at 259-73..

savings deposits and long-term loans, are now also engaged in the short-term deposit and credit markets, and their central institutions — the regional *Landesbank*& — are active in large-scale lending, industrial financing, and the securities business. In addition, the central institutions provide a Clearing system and a variety of other banking services for their associated savings banks. At the same time, the commercial banks have penetrated the savings deposit business formerly dominated by the savings banks. Substantially all savings banks in Germany are organized under public law by municipalities, counties, or associations of municipalities, and the *Landesbanken* are also established under public law and owned either by the states, the savings banks of the states, associations of the savings banks, or a combination thereof.<sup>14</sup>

At the end of September 1992 there were 337 commercial banks in Germany, with total assets of DM 1,508 billion. Of these banks, 198 were widely held commercial banks, 57 were subsidiaries or branches of foreign banks, and 82 were closely held commercial banks. In addition, there were 724 savings banks organized under public law by municipal, regional, or state authorities, and 13 central institutions (*Landesbanken*). Germany's banking system also includes 2,963 industrial and agricultural credit cooperatives, and allied institutions and their four central institutions.<sup>15</sup> All of these institutions are universal banks.

Besides these universal banking institutions, there are also specialized credit institutions such as mortgage banks, ship mortgage banks, building and loan associations, and investment

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14. For a detailed discussion of several *Landesbanken*, in particular of the liability of the states and municipalities for the obligations of the *Landesbanken*, see Registration Statement of Südwestdeutsche Landesbank Girozentrale (Securities and Exchange Commission Registration Statement No. 33-56342, filed December 24, 1992); Offering Circular of Bayerische Landesbank Girozentrale, New York Branch, dated December 4, 1992, relating to \$250,000,000 7-H % Subordinated Notes Due December 14, 2002 (Office of the Comptroller of the Currency Registration Statement); Prospectus of Landeskreditbank Baden-Württemberg dated February 1, 1993 under Prospectus Supplement dated February 1, 1993 relating to \$300,000,000 7-H % Subordinated Notes Due 2023, at 466.47 (Securities and Exchange Commission Registration Statement No. 33-46771) [hereinafter Landeskreditbank Baden-Württemberg Prospectus].

As to the history of the savings bank and *Landesbanken*, see Günter Ashauer, *Entwicklung der Sparkassenorganisation ab 1924*, in: 3 DEUTSCHE BANKENGESCHICHTE 279-83 (1983).

15. Monthly Report of the Deutsche Bundesbank, Nov. 1992, table III, 13 [hereinafter Monthly Report]. See Landeskreditbank Baden-Württemberg Prospectus, *supra* note 14, at 65.

companies under the Investment Companies Act. These institutions need a license under the *Kreditwesengesetz* (KWG) and, in addition, must comply with the provisions of the special laws governing their activities. Mortgage banks (*Hypothekenbanken*), organized either under public law (*Grundkreditanstalten*) or under the general corporate law, are specialized in, and also limited by law to, activities like long-term lending to private building owners and public authorities.<sup>16</sup> They finance their lending mostly through the issuance of mortgage-backed bonds<sup>17</sup> and public debt-backed bonds,<sup>18</sup> but they also issue short-term and medium-term bank bonds. Of the 35 mortgage banks in existence at the end of September 1992, seven were mortgage banks organized under public law with total assets of DM 37,642 million.<sup>19</sup> The building and loan associations (*Bausparkassen*) — the most rapidly expanding institutions in post-war Germany due to the housing needs of the Population — accept deposits from customers to build up a basis for future loans to these customers under specific conditions and only for the purpose of housing. In addition, at the end of September 1992 there were eighteen credit institutions with special purposes.

#### IV. ELEMENTS OF THE GERMAN UNIVERSAL BANKING SYSTEM

##### A. Permitted Activities

The universal banking system in Germany allows banks to

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— 16. M. Pohl, *Entwicklung*, *supra* note 9, at 250-53.

17. *Pfandbriefe*, or mortgage-backed bonds, are generally long-term bonds (with an original maturity of four years or longer), the principal and interest of which are at all times secured by a pool of specified mortgage loans listed in a register maintained by the credit institution. The pool is replenished as required to keep the mortgage-backed bonds fully secured. Mortgage-backed bonds may be issued in registered or bearer form. See *Hypothekenbankgesetz* (Mortgage Bank Law) § 6, 1990 *Bundesgesetzblatt* [BGBl.] I 2898, (F.R.G.); *Gesetz über die Pfandbriefe und verwandte Schuldverschreibungen öffentlich-rechtlicher Kreditanstalten* (Law Relating to Mortgage-backed Bonds of Public Sector Banks) § 2, 1963 BGBl. I 312, (F.R.G.) [hereinafter *Gesetz über die Pfandbriefe*].

18. *Kommunalobligationen*, or public debt-backed bonds, are generally long-term bonds (with an original maturity of four years or longer), the principal and interest of which are at all times secured by a pool of specified loans listed in a register maintained by the credit institution and made by the credit institution to German public authorities or entities organized under public law or to certain European Community entities, or guaranteed or otherwise secured by such authorities or entities. The pool is replenished as required to keep the public debt-backed bonds fully secured. Public debt-backed bonds may be issued in registered or bearer form. See *Gesetz über die Pfandbriefe*, *supra* note 17, § 8.

19. See *Monthly Report*, *supra* note 15.

offer a **variety of financial services** to their customers, such as the taking of **deposits**, consumer and **commercial** lending, **securities** underwriting and trading, mutual **fund** operations, and investment advising. Section 1(1) of the German Banking Law, the KWG, **enumerates** certain activities and provides that any **enterprise** engaging in one or more of such activities on a **scale** that requires a **commercially** organized business Operation is a **banking** institution (*Kreditinstitut*), and is **subject** to the licensing requirements and other provisions of the KWG.<sup>20</sup> (The following text **refers to** licensed banking institutions as "banks.") Thus, the purpose of Section 1 of the KWG is not to enumerate activities that are permissible to **banks**, but to establish the requirement of a **banking license** for certain activities. The enumeration of Section 1 of the KWG does not include certain activities frequently **carried on** by banks, and **licensed** banks may engage in activities not enumerated in Section 1. The commencement and termination of activities not enumerated in Section 1 **must**, however, be reported to the Federal Banking Supervisory Authority

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20. Gesetz über das Kreditwesen [KWG] § 1, 1961 BGBl. 1 881 (F.R.G.) [hereinafter KWG]. Most recently amended by the Gesetz zur Änderung des Gesetzes über das Kreditwesen und anderer Vorschriften über Kreditinstitute (Law for the Change of the Banking Law and of Other Provisions Relating to Banks) 1992 BGBl. 1 2211-28 (F.R.G.) [hereinafter KWG, 1993 Amendments]. Banking activities are defined as:

1. The acceptance of monies from others as deposits, irrespective of whether or not interest is paid thereon (deposit business);
2. The granting of money loans and acceptance credits (lending business);
3. The purchase of drafts and checks (discount business);
4. The purchase and sale of securities for the account of others (securities business);
5. The custody and administration of securities for the account of others (safe custody business);
6. The transactions specified in Section 1 of the Investment Companies Act (Gesetz über Kapitalanlagegesellschaften, *infra* note 23) (investment business);
7. The incurring of the obligation to acquire claims in respect to loans prior to their maturity;
8. The issuance of guarantees and other warranties on behalf of others (guarantee business); and
9. The performance of cashless payment and clearing operations (giro business).

The Federal Minister of Finance, after consultation with the *Deutsche Bundesbank* [hereinafter German Federal Bank], may by regulation designate further activities as banking activities if, in the accepted view of the business community, this is justified having regard to the regulatory purposes of the KWG. KWG, § 1.

For English language translation of the KWG, see MARTIN PELTZER & JERMYN P. BROOKS, *GERMAN BANKING LAW - GESETZ ÜBER DAS KREDITWESEN* 6 (3d ed. 1990); HANES SCHNEIDER ET AL., *THE GERMAN BANKING SYSTEM - DAS BANKWESEN IN DEUTSCHLAND* (4th ed. 1986); Deutsche Bundesbank Special Series, No. 2. *BANKING ACT OF THE FEDERAL REPUBLIC OF GERMANY* (1966); Rudolf Panowitz & Harald Jung, *KREDITWESENGESETZ-BANKING Am. GERMAN-ENGLISH COMMENTARY* (1988).

(Supervisor-y Authority) (*Bundesaufsichtsamt für das Kreditwesen*).” Some non-enumerated activities are customary to banks, such as underwriting, factoring, forfeiting, financial leasing, dealing in precious metals and collectors’ coins, and dealing in foreign exchange. Banks not only may engage in securities brokerage business, but also may act as real estate brokers.<sup>22</sup> German banking law does not differentiate between commercial banks and investment banks and has no equivalent to the Glass-Steagall Act.

There are, however, some limitations on the activities in which a bank may engage. Banks may not engage in investment business as defined in Section 1 of the Investment Companies Act.<sup>23</sup> Banks also may not engage in the insurance business, which means they may not issue insurance policies. Insurance companies require a license from the Federal Insurance Supervisory Office (*Bundesaufsichtsamt für das Versicherungswesen*) to conduct insurance business, and such licenses will not be granted to banks.” However, banks may act as brokers for the sale of insurance policies issued by licensed insurance companies.<sup>24</sup> As will be discussed below, banks may also own insurance companies.<sup>25</sup> It follows from the above discussion that the approach of the KWG differs radically from the approach of the United States bank regulations: In Germany a variety of activities require a banking license, but a licensed bank is not restricted from engaging in other activities. In the United States, however, essentially only one activity — the combination of lending and deposit-taking — requires a banking license, and a licensed bank is limited to a rather narrow range of activities. In Germany, once an enterprise has been licensed as a bank, it may expand its activities, whereas in the United States, an enterprise licensed as a bank must refrain from all activities other than

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21. KWG, *supra* note 20, § 24(1) No. 9. See Ekkehard Bauer, *Regulation in Germany, in REGULATION OF FOREIGN BANKS - UNITED STATES AND INTERNATIONAL*, § 13.07 at 13-12 to 13-13 (Michael Gruson & Ralph Reiser eds., 1991) [hereinafter Bauer, *Regulation in Germany*].

22. Bauer, *Regulation in Germany, supra* note 21, § 13.07, at 13-12 to 13-13.

23. Bauer, *Regulation in Germany, supra* note 21, § 13.07, at 13-11. On the other hand, investment companies must have a banking license. Gesetz über Kapitalanlagegesellschaften (Investment Companies Act) § 2(1), 1970 BGBl. I 127, as amended (F.R.G.); KWG, *supra* note 20, § 1(1), sentence 2, No. 6.

24. Bauer, *Regulation in Germany, supra* note 21, § 13.07, at 13-12 to 13-13.

25. Bauer, *Regulation in Germany, supra* note 21, § 13.07, at 13-13.

26. See *infra* note 27 and accompanying text.



narrowly defined banking activities. The United States regulations do not cover a large number and variety of financial institutions that compete with banks in the financial Services market, but they do severely restrict and, some observers say, overregulate the few financial institutions that they do cover. Many observers feel that non-bank financial institutions enjoy a substantial competitive advantage. The German banking license, on the other hand, must be understood as a license required to provide any financial service.

### *B. Permitted Investments*

A German bank may invest in other banks, as well as in commercial, industrial, and insurance companies. The only limitation is that the aggregate book value of the investments of a bank (exceeding 10% of the capital of the target companies) in stockholdings and other assets deemed to be illiquid must not exceed the liable capital of the bank.<sup>27</sup> The 1993 Amendments to

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27. The KWG, 1993 Amendments provide that investments by a bank in real estate, buildings, operating and business equipment, ships and shares in banks and other enterprises, as well as in rights resulting from capital contributions as silent partner (*stiller Gesellschafter*), from participation rights (*Genussrechte*), and from loans pursuant to Section 10(5a) of the KWG to other banks [subordinated loans], may not, in the aggregate, measured by book value, exceed the liable capital of the bank. KWG, 1993 Amendments, *supra* note 20, § 12(1). Investments in shares of a company are disregarded for this computation if they do not exceed 10% of the capital of such company. In addition, investments in certain securities of a company held in the bank's trading account that do not exceed 5% of the capital of such company are also disregarded for such computation. KWG, *supra* note 20, § 12(2) Nos. 1 & 2.

Certain investments in banks and financial institutions (other than investment companies) are not subject to the limitation of Section 12(1) of the KWG, i.e., these investments are deducted from liable capital and are not added to the sum of investments that may not exceed the liable capital: (i)(x) each investment in a bank or financial institution if such investment exceeds 10% of the capital of such bank or financial institution, and (y) subordinated loans to, rights under participation rights (*Genussrechte*) in, and preferred shares of, banks and financial institutions if the investor bank has an investment in the target bank or financial institution exceeding 10% of the capital of such bank or financial institution and (ii) the aggregate amount of (x) each investment in a bank or financial institutions up to and including 10% of the capital of such bank or financial institution, and (y) subordinated loans to, rights under participation rights in, and preferred shares of, banks and financial institutions if the investor bank has no investment in the target bank or financial institution or only an investment of up to and including 10% of the capital of such bank or financial institution, provided that the amount of (ii) is deducted from liable capital and disregarded for purposes of Section 12(1) of the KWG in the version of the 1993 Amendments only to the extent it exceeds 10% of the liable capital of the investor bank. KWG, 1993 Amendments, *supra* note 20, § 12(1) (referring to KWG, 1993 Amendments, *supra* note 20, § 10(6a), sentence 1, Nm 4 & 5).

the KWG,<sup>28</sup> which transform the Second Banking Directive of the EEC<sup>29</sup> into German law, also provide that a bank's "significant investment" (investment of at least 10%) in an enterprise (other than a bank, a financial institution, an insurance company, or a company providing supporting services to the bank) may not exceed 15% of the liable capital of such bank, and all such significant investments of a bank in the aggregate may not exceed 60% of the liable capital of such bank.<sup>30</sup> A bank may

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A "financial institution" is an enterprise that is not a bank within the meaning of Section 1 of the KWG but which is principally engaged in investing in other companies, purchasing receivables, leasing, issuance or administration of credit cards or travelers checks, dealing for its own account or for the account of customers in foreign currencies, dealing for its own account in securities, dealing for its own account or for the account of customers in forward contracts, options, and other hedging instruments relating to currencies and interest rates, underwriting of securities; consulting on and providing of services in connection with the capital structure, industrial strategies and M&A of enterprises, arranging of loans among banks (money brokerage services), managing of securities portfolios and providing investment advice. KWG, 1993 Amendments, *supra* note 20, § 1(3). See Michael Gruson & Wolfgang Feuring, *The New Banking Law of the European Economic Community*, 25 INT'L L.W. 1, 14 (1991) [hereinafter Gruson & Feuring].

28. KWG, 1993 Amendments, *supra* note 20.

29. Second Council Directive 89/646 of 15 December 1989 on the Coordination of Laws, Regulations and Administrative Provisions Relating to the Taking Up and Pursuit of the Business of Credit Institutions and Amending Directive 77/780, 1989 O.J. (L 386) 1 [hereinafter Second Banking Directive]. See generally Gruson & Feuring, *supra* note 27; Michael Gruson & Werner Nikowitz, *The Second Banking Directive of the European Economic Community and Its Importance for Non-EEC Banks*, 12 FORDHAM INT'L L.J. 205 (1989); Michael Gruson & Werner Nikowitz, *The Reciprocity Requirement of the Second Banking Directive of the European Economic Community Revisited*, 12 FORDHAM INT'L L.J. 452 (1989); Uwe H. Schneider, *Die Harmonisierung der Bankrechts in der Europäischen Gemeinschaft*, 89 ÖSTERREICHISCHES BANKARCHIV, Zeitschrift für das Gesamte Bank- und Börsenwesen 312 (1991); Uwe H. Schneider, *The Harmonization of EC Banking Laws: The Euro-Passport To Profitability and International Competitiveness of Financial Institutions*, 22 LAW & POL'Y INT'L BUS. 261 (1991); Udo-Olaf Bader, *Regulation by the European Communities, in REGULATION OF FOREIGN BANKS - Um STARS AND INTERNATIONAL* (Michael Gruson & Ralph Reisner eds., 1991).

30. KWG, 1993 Amendments, *supra* note 20, § 12(5). See Second Banking Directive, *supra* note 29, arts. 12(1) & 12(2); Gruson & Feuring, *supra* note 27, at 10. The limitations of Section 12(5) of the KWG only apply to banks that are engaged in taking deposits from the public and providing credit.

"Significant investment" (*bedeutende Beteiligung*) is defined in the KWG, 1993 Amendments, as (i) a direct or indirect investment in at least 10% of the capital or the voting rights of a target company or (ii) the possibility of the exercise of a significant influence over the management of the enterprise in which an investment has been made. KWG, 1993 Amendments, *supra* note 20, § 1(9). See Second Banking Directive, *supra* note 20, art. 1(10); Gruson & Feuring, *supra* note 27, at 10.

Investments by a bank in other enterprises are not subject to the restrictions of section 12(5) of the KWG if such investments are not intended to serve the business of the bank through creation of a long-term connection to the target company. Cf. Handelsgesetzbuch (German Commercial Code) [HGB] § 271(1) (using the same concept); for an

exceed the 15% and 60% limitation on investments if it covers the significant investments in excess of these limits by liable capital and does not include that portion of its liable capital in the calculation of its capital ratios.<sup>31</sup>

Investments (significant or otherwise) in banks, financial institutions, and insurance companies are not subject to the 15% and 60% capital limitation.<sup>32</sup> Apparently, the legislature is of the opinion that because investments in banks, financial institutions, and insurance companies are subject to regulation, they do not carry the same risk as investments in unregulated commercial and industrial enterprises.<sup>33</sup> In addition, any investments in excess of 10% of the capital of target banks and financial institutions are not subject to the limitation that all investments of an investor bank may not exceed the investor bank's liable capital, and such investments of 10% or less are not subject to such limitations only if they exceed in the aggregate 10% of the liable capital of the investor bank.<sup>34</sup> The reason for disregarding these

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example, see Financial Statements, Landeskreditbank Baden-Württemberg Prospectus, *supra* note 14, at Supp. nn. 9 & 12. This permission of short-term investments outside the restrictions of Section 12(5) of the KWG would cover investments in connection with debt previously contracted or underwritings. See Second Banking Directive, *supra* note 29, art. 12(4); Gruson & Feuring, *supra* note 27, at 10. As to companies providing supporting services to a bank, see Gruson & Feuring, *supra* note 27, at 52.

The exclusion from Section 12(5) of the KWG of such non-permanent investments reflects the provision of Art. 12(4), Sentence 2 of the Second Banking Directive, which provides that the investment limitations of Article 12(1) and (2) of the Second Banking Directive do not apply to shares that do not constitute financial fixed assets in accordance with Article 35(2) of the Council Directive 86/635 of 8 December 1986 on the Annual Accounts and Consolidated Accounts of Banks and Other Financial Institutions, 1986 O.J. (L 372) 1.

31. KWG, 1993 Amendments, *supra* note 20, § 12(5). Section 12 (5) refers to the ratios to be computed pursuant to the regulations of the Supervisory Authority promulgated or to be promulgated pursuant to KWG, *supra* note 20, §§ 10(1), sentence 2 & 10a(1), sentence 1. See Gruson & Feuring, *supra* note 27, at 11.

32. See KWG, 1993 Amendments, *supra* note 20, § 12(5).

33. The Second Banking Directive, *supra* note 29, saw a risk in participation by banks in other companies because such participation may affect the soundness of the bank if the subsidiary runs into financial difficulties (contagion risk) and because such participation constitutes a long-term freeze on the assets of the investing bank, but the Directive excluded credit institutions (banks) and financial institutions from the restriction on participation. See Proposal for a Second Council Directive, COM(87)715 final at II 3 (b) (explanatory memorandum accompanying the proposal for the Second Banking Directive). See also Gruson & Feuring, *supra* note 27, at 10; Michael Gruson, *Investment in Foreign Equity Securities and Debt-Equity Conversion by U.S. Banks, Bank Holding Companies, and Foreign Bank Holding Companies*, 1988 COLUM. BUS. L. REV. 441.

34. KWG, 1993 Amendments, *supra* note 20, § 10(6a), sentence 1, Nos. 4 & 5 & § 12(1). See also *supra* note 27. Note that a significant investment is an investment of at least 10%, i.e., the term includes investments of 10%. KWG, 1993 Amendments, *supra*

investments in banks and financial institutions from the liable capital limitation is that these investments are deducted from the capital of the investor bank for purposes of computing its liable capital.<sup>35</sup> Non-significant (10% or less) investments in target banks and financial institutions that amount in the aggregate to 10% or less of the liable capital of the investor bank are subject to the overall restriction that all investments of a bank may not exceed the bank's liable capital.<sup>36</sup> All investments in insurance companies are subject to the limitation that all investments of a bank may not exceed the bank's liable capital.

There are also limitations regarding large credits (*Grosskredite*) — credits to a single borrower or group of borrowers — that restrict a bank's investments.<sup>37</sup> Credits to a single customer that exceed 15% of the liable capital of a bank are "large credits" and must be promptly reported to the German Federal Bank. All disbursed large credits in the aggregate may not exceed eight times the liable capital of the bank, and no single large credit may exceed 50% of the liable capital of a bank.<sup>38</sup> The KWG defines "credits" to include the holding of shares or other participation by a bank in a borrower's enterprise if it amounts to at least one-fourth of the capital of such enterprise.<sup>39</sup>

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note 20, § 1(9). The treatment of investments in banks and credit institutions for purposes of the computation of liable capital and for purposes of the rule that all investments of an investor bank may not exceed such bank's liable capital depends on whether the target banks' investment is *more than* 10%, i.e., investments of 10% are not included. KWG, 1993 Amendments, *supra* note 20, § 10(6a).

35. KWG, 1993 Amendments, *supra* note 20, § 10(6a), sentence 1, nos. 4 & 5.

36. *See supra* note 27. These investments are not deducted from the capital of the investor bank for purposes of computing its liable capital. KWG, 1993 Amendments, *supra* note 20, § 10(6a), sentence 1, No. 5.

37. KWG, *supra* note 20, § 13. *See* Council Directive 91/121 of 21 December 1992 on Monitoring and Controlling Large Exposures of Credit Institutions, 1993 O.J. (L 29) 1, and Commission Recommendations 87/62 on Monitoring and Controlling Large Exposures of Credit Institutions, 1987 O.J. (L 33) 10; Gruson & Feuring, *supra* note 27, at 33-35.

38. KWG, *supra* note 20, §§ 13(1), 13(3) & 13(4). KWG, 1993 Amendments, *supra* note 20, § 13(8) contains special rules as to the computation of liable capital for purposes of section 13 of the KWG. Essentially, the definition of liable capital of section 13(8) deletes most additions to the liable capital added by the 1993 Amendments and thus applies a narrower concept of liable capital. KWG, 1993 Amendments, *supra* note 20, § 13(8).

39. The KWG defines "credits" for purposes of section 13 of the KWG as including equity investments by a bank in a borrower's enterprise, if the investment amounts to at least one quarter of the capital (nominal capital or number of shares) of such enterprise, regardless of the duration of such holding. KWG, *supra* note 20, § 19(1).

The duration of the investment is irrelevant.<sup>40</sup>

### C. Permitted Shareholders

As far as the ownership of a bank is concerned, German banking law, prior to the 1993 Amendments to the KWG, did not limit such ownership to certain kinds of investors or to certain percentages, nor did it require reports about the owners.<sup>41</sup> Industrial and commercial companies could own banks, and in some cases the authorities, and even the bank itself, did not know the owners. The 1993 Amendments incorporate the rules of the Second Banking Directive on shareholdings in credit institutions,<sup>42</sup> and the new Section 2(b) of the KWG provides that a person who intends to make a significant investment (10% or more)<sup>43</sup> in a bank must promptly inform the Supervisory Authority and the German Federal Bank. The notice must contain information demonstrating the reliability of the investor and its officers. The owner of a significant investment must also report to the Supervisory Authority and the German Federal Bank a proposed increase of a significant investment that would result in the investment reaching or passing the threshold of 20%, 33%, or 50% of voting rights or capital of the bank, or would result in the bank becoming such investor's subsidiary.<sup>44</sup> The Supervisory Authority can deny the investment within three months if it is not satisfied with the reliability of the investor or its officers,<sup>45</sup> or if an effective supervision of the bank is not possible because of the investment or the relationship of the inves-

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40. KWG, *supra* note 20, § 19(1).

41. For the situation in the United States, see Eric B. Fischman, *Expanding Bank Ownership: A Necessity For the Financial Stability, Economic Efficiency and Global Competitiveness of the U.S. Banking Industry*, 11 ANN. REV. BANKING L. 509 (1992); E. GERALD CORRIGAN, FINANCIAL MARKET STRUCTURE: A LONGER VIEW in FED. RESERVE BANK ANN. REP. at 6, 39 (1987); Treasury Dep't Recommendations, *supra* note 1, at XVIII-22 to XVIII-23.

42. Second Banking Directive, *supra* note 29, arts. 5 & 11. See Gruson & Feuring, *supra* note 27, at 11-13.

43. See *supra* note 30 (discussion of significant investments).

44. The KWG, 1993 Amendments define "subsidiary" as an enterprise that is a subsidiary in the meaning of HGB, *supra* note 30, § 290. KWG, 1993 Amendments, *supra* note 20, § 1(7). Section 290 of the Handelsgesetzbuch defines the subsidiary of a parent as a company in which the parent has the majority of votes, or as to which the parent has the right to elect or dismiss the majority of the members of the administrative or supervisory board or as to which the parent has the right to exercise a controlling influence on the basis of an agreement with the subsidiary (*Beherrschungsvertrag*) or on the basis of a provision in the charter of the subsidiary. HGB, *supra* note 30, § 290(2).

45. KWG, 1993 Amendments, *supra* note 20, §§ 2b(1) & 33(1), sentence 1, No. 2a.

tor with other enterprises.<sup>46</sup> Likewise, any shareholder owning a significant investment in a bank who intends to dispose of that investment, or to reduce it below the benchmarks of 20%, 33%, or 50% measured by voting rights or capital, or to reduce the investment below the subsidiary level must inform the Supervisory Authority and the German Federal Bank.<sup>47</sup> The 1993 Amendments to the KWG make certain that the owner of a significant investment in a bank will be known to the German banking authorities; it does not change the principle that industrial and commercial companies may invest in or own banks.

#### D. Summary

The foregoing discussion indicates that the German universal banking system is characterized by three aspects:

(1) Universal banking means that a bank may offer all kinds of financial services, including securities services, to its customers;

(2) Universal banking means that a bank may be related to non-banking corporations in that a bank may own equity interests in, or otherwise control, other enterprises in the financial sector as well as in commercial or industrial enterprises; and,

(3) Universal banking means that a bank may be related to non-banking corporations in that non-financial enterprises may invest in, own all of the equity of, or otherwise control a bank provided the regulator considers the investor to be reliable.

These three aspects of the universal banking system must be clearly distinguished from each other, although this is not always done. A legal development that liberalizes restrictions in one area (*i.e.*, the kind of services permitted to be performed by

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46. KWG, 1993 Amendments, *supra* note 20, § 33(1), sentence 2. This Section provides that approval of an investment may be denied if: (i) the bank and the investor who owns a significant investment in the bank are "connected" (*verbunden*) in the meaning of the Aktiengesetz [Corporation Law] § 15, 1965 BGBL I 1089, as amended (F.R.G.), and (ii) because of this connection between the investor and the bank or because of the structure of connections between the owner of the significant investment and other enterprises an effective supervision of the bank is not possible. A connection in the meaning of § 15 of the Aktiengesetz is created if a company owns a majority of the shares or voting rights of another company, if a company has the possibility to exercise a dominant position over another company, if a dominant enterprise and one or more dependent enterprises are managed together by the dominant enterprise (*Konzern*), or if each of two companies own more than 25% of the shares of the other company. The Supervisory Authority also has the power to deny the owner of a significant investment the exercise of his voting rights. KWG, 1993 Amendments, *supra* note 20, § 2b(2).

47. KWG, 1993 Amendments, *supra* note 20, § 2b(4).

a bank) does not necessarily have an influence on the other areas.

## V. THE REGULATION OF BANKS IN GERMANY

### A. Applicable Laws

Banks in Germany are subject to extensive supervision and regulation comparable in many respects to the supervision of United States commercial banks. Laws on banking are enacted by the German Federal legislature (*Bundestag*), and the states only retain the right to enact laws concerning their own state banks and savings banks established under state law and their central institutions (*Landesbanken*).<sup>48</sup> These state statutes may impose additional regulatory requirements and operational limitations on the state banks. The most important federal banking laws are the KWG,<sup>49</sup> the Investment Companies Act,<sup>50</sup> and the Securities Deposit Act.<sup>51</sup> The KWG, as last amended on January 1, 1993, transformed into German law the Second Banking Directive<sup>52</sup> and the Council Directive of 17 April 1989 on Own Funds of Credit Institutions.<sup>53</sup> In 1985 the KWG had been

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48. Banking law is subject to the legislative jurisdiction of the states only as long as and to the extent the Federal legislature has not acted in this area. GRUNDGESETZ [Constitution] [GG] arts. 72 & 74, No. 11 (F.R.G.). See MICHAEL GRUSON, *DIE BEDÜRFNIS-KOMPETENZ* 29 (1967). For state laws, see e.g., the Baden-Württemberg law regulating savings banks and creating and regulating Südwestdeutsche Landesbank Girozentrale, Sparkassengesetz of Baden-Württemberg, 1992 Baden-Württemberg Gesetzblatt [Official State Gazette, hereinafter BW GBl] 128, and the Baden-Württemberg law creating and regulating a specialized state bank, Gesetz über die Landeskreditbank Baden-Württemberg 1972 BW GBl 129, as amended (F.R.G.).

49. See *supra* note 20.

50. See Gesetz über Kapitalanlagegesellschaften, *supra* note 23.

51. Gesetz über die Verwahrung und Anschaffung von Wertpapieren (Depotgesetz) [Securities Deposit Act] 1937 Reichsgesetzblatt [Official Gazette, hereinafter "RGGBl"] 171, as amended (F.R.G.).

The industrial and agricultural credit cooperatives are governed by the Gesetz betreffend die Erwerbs- und Wirtschaftsgenossenschaften [Business and Trade Cooperatives Act] 1889 RGGBl 55 in 1898 RGGBl 369, 810, as amended, and the Deutsche Genossenschaftsbank is incorporated on the basis of the Gesetz über die Deutsche Genossenschaftsbank [Act on the Deutsche Genossenschaftsbank] 1975 BGBl I 3171 (F.R.G.).

Laws dealing with specialized banks are Gesetz über Bausparkassen [Act on Building and Loan Associations] 1991 BGBl I 454 (F.R.G.); Hypothekendarlehenbankengesetz [Mortgage Bank Act] 1990 BGBl I 2898 (F.R.G.); Gesetz über Schiffspfandbriefbanken (Schiffbankengesetz) [Ship Mortgage Bank Act] 1963 BGBl I 302, as amended (F.R.G.).

52. See *supra* note 29.

53. Own Funds Directive, Council Directive 89/299, 1989 O.J. (L 124) 16 [hereinafter Own Funds Directive]. The Council Directive of 18 December 1989 on a Solvency

amended to take into consideration the recommendations on supervision on a consolidated basis of the Basle Committee on Banking Regulation and Supervisory Practices,<sup>54</sup> and to add the principle of consolidation for the reporting of banking groups, the monitoring of their capital basis, and the limiting of their large loans.<sup>55</sup>

### B. Regulation of Entry

The first step required in order to start a banking business in Germany is to receive a banking license from the Supervisory Authority.<sup>56</sup> An adequate liable capital, a business and organization plan, and at least two managers having the professional qualifications necessary to manage a bank are required as a precondition to obtaining a banking license.<sup>57</sup> A banking license is necessary as soon as one of the activities listed in section 1 of the KWG<sup>58</sup> is conducted on a commercial basis. Once a license is issued, the bank is entitled to open branches in all parts of Germany and abroad.<sup>59</sup> The license requirement also applies to branches of foreign banks from countries outside the European Economic Community (EEC), where each branch needs its own license.<sup>60</sup> The 1993 Amendments to the KWG implement the

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Ratio for Credit Institutions, 89/647, 1989 O.J. (L 386) 14 [hereinafter Solvency Ratio Directive], will be transformed by regulation of the Supervisory Authority promulgated pursuant to Section 10(1) of the KWG. See Gruson & Feuring, *supra* note 27, at 28-33.

54. Basle Committee on Banking Regulations and Supervisory Practices, *Report on the Supervision of Banks' Foreign Establishments*. The original 1975 Concordat, released to the public in March 1981, is reproduced in International Monetary Fund, *International Capital Markets: Recent Developments and Short-Term Prospects*, 1981, OCCASIONAL PAPER No. 7, Aug. 1981, at 29-32. It was revised in Committee on Banking Regulations and Supervisory Practices, *Revised Basle Concordat on Principles for the Supervision of Banks' Foreign Establishments*, May 1983. The Concordat was further supplemented in April 1990, Basle Committee on Banking Supervision, *Information Flows Between Banking Supervisory Authorities*, April 1990 and *Supplement to the Concordat*, April 1990.

55. See KWG, *supra* note 20, §§ 10a, 12a & 13a.

56. KWG, *supra* note 20, § 32. See Bauer, *Regulation in Germany*, *supra* note 21, § 13.09, at 13-15 to 13-16.

57. KWG, *supra* note 20, §§ 32 & 33. See Bauer, *Regulation in Germany*, *supra* note 21, § 13.09, at 13-15.

58. See *supra* note 20.

59. See Bauer, *Regulation in Germany*, *supra* note 21, § 13.09 at 13-16. Openings and closings of branches must only be reported to the Supervisory Authority. Bauer, *Regulation in Germany*, *supra* note 21, § 13.10, at 13-16.

60. See Bauer, *Regulation in Germany*, *supra* note 21, § 13.10, at 13-16 to 13-17. The First Council Directive of 12 December 1977 on the Coordination of Laws, Regulations and Administrative Provisions Relating to the Taking Up and Pursuit of the Busi-



"European passport" concept of the Second Banking Directive and provide that credit institutions authorized in another EEC member state (Member State) are entitled to offer their services freely to individuals and businesses in Germany and to establish branches in Germany without the need for any further authorization.<sup>61</sup>

### C. Capital Adequacy and Liquidity

In order to protect the integrity of the German banking system, the KWG and the regulations of the Supervisory Authority thereunder impose certain requirements with respect to the capital adequacy and liquidity of banks. These rules on capital adequacy and liquidity, which predate the Basle Agreement on Capital Standards,<sup>62</sup> may be viewed as the core of German banking regulation.

In order to be able to meet their obligations to their creditors, banks must maintain adequate liable capital. The term "liable capital" (*haftendes Eigenkapital*) is defined in section 10 of the KWG, which has been amended by the 1993 Amendments to incorporate the rules of the Own Funds Directive.<sup>63</sup> Section

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ness of Credit Institutions, 77/780, art. 9(1), 1977 O.J. (L 322) 30, requires that member states do not grant more favorable treatment to branches of non-EEC credit institutions than that accorded to EEC credit institutions. See Gruson & Feuring, *supra* note 27, at 3.

61. KWG, 1993 Amendments, *supra* note 20, § 53b. See Second Banking Directive, *supra* note 29, arts. 6(1) & 18(1). See also Gruson & Feuring, *supra* note 27, at 3-7.

An EEC credit institution may directly or through branches engage in Germany in the activities enumerated in § 1, Sentence 2, Nos. 1 to 5 and 7 to 9 of the KWG (excluding No. 6, the transactions specified in Section 1 of the Investment Companies Act). The 1993 Amendments to the KWG take the position that the activities listed in § 1 of the KWG are identical with, or at least not more narrow than, the activities listed in the Annex to the Second Banking Directive because the Annex defines the scope of the principle of mutual recognition of the banking licenses of other EEC member states: each member state must ensure that at least the activities listed in the Annex may be pursued in its territory by any credit institutions authorized and supervised by its EEC home member state. See Gruson & Feuring, *supra* note 27, at 4.

62. The Basle Committee on Banking Regulations and Supervisory Practices, *International Convergence of Capital Measurement and Capital Standards*, 30 I.L.M. 978 (June 1988) [hereinafter *Basle Agreement*]. For further discussion of the *Basle Agreement*, see Joseph J. Norton, *The Work of the Basle Supervisors Comm. on Bank Capital Adequacy and the July 1988 Report on Int'l Convergence of Capital Meas. and Capital Standards*, 23 INT'L LAW. 245 (1989); Duncan E. Alford, *Basle Committee International Capital Adequacy Standards: Analysis and Implications for the Banking Industry*, 10 DICK. J. INT'L L. 189 (1992); Camille M. Caesar, *Capital-Based Regulation and U.S. Banking Reform*, 101 YALE L.J. 1525 (1992).

63. See *supra* note 53.

10 lists the items that liable capital may comprise. These items include: (1) the different types of equity capital, depending on the legal form of organization of the bank;<sup>64</sup> (2) net profit to the extent such profit is allocated to the capital or retained earnings reserves of the bank;<sup>65</sup> (3) certain reserves and provisions, subject to limitations<sup>66</sup> (including, subject to limitations, a certain percentage of non-realized reserves based on the difference between book value and real value of real estate and securities<sup>67</sup>); (4) preferred stock;<sup>68</sup> (5) contributions of silent partners (*stille Gesellschafter*) meeting certain requirements;<sup>69</sup> (6) subordinated debt meeting certain requirements;<sup>70</sup> and, (7) capital paid in against issue of participation rights (*Genussrechte*) meeting certain requirements.<sup>71</sup>

Section 10 of the KWG in the 1993 Amendments further requires that specific items which do not serve as loss or insolvency protection be deducted from liable capital. These items include: (1) losses;<sup>72</sup> (2) certain intangible assets<sup>73</sup> (which include goodwill, certain formation expenses, licenses, trademarks, and similar rights); (3) certain holdings in other credit institutions or financial institutions exceeding 10% of such other institutions' capital;<sup>74</sup> and, (4) certain holdings in other credit institutions or financial institutions of up to 10% of such other institutions' capital to the extent such investments exceed in the aggregate 10% of the liable capital of the investor bank.<sup>75</sup>

Liable capital not only serves as a cushion to withstand business losses, but is also used as a benchmark to limit the volume of a bank's activities. The aggregate book value of illiquid assets may not exceed the bank's liable capital.<sup>76</sup> The liable capital

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64. KWG, *supra* note 20, § 10(2).

65. KWG, *supra* note 20, § 10(3).

66. KWG, 1993 Amendments, *supra* note 20, §§ 10(4a), (4b) & (4c).

67. KWG, 1993 Amendments, *supra* note 20, §§ 10(3) & 10(4a).

68. KWG, 1993 Amendments, *supra* note 20, § 10(4a).

69. KWG, 1993 Amendments, *supra* note 20, § 10(4).

70. KWG, 1993 Amendments, *supra* note 20, § 10(5a).

71. KWG, 1993 Amendments, *supra* note 20, § 10(5).

72. KWG, 1993 Amendments, *supra* note 20, § 10(6a).

73. KWG, 1993 Amendments, *supra* note 20, § 10(6a).

74. KWG, 1993 Amendments, *supra* note 20, § 10(6a). See *supra* note 27 for a discussion of this section.

75. KWG, 1993 Amendments, *supra* note 20, § 10(6a). See *supra* note 27 for a discussion of this section. For a discussion of liable capital under the Second Banking Directive, which calls liable capital "own funds", Gruson & Feuring, *supra* note 27, at 31-33.

76. KWG, *supra* note 20, § 12. For a discussion of section 12, see *supra* text accom-

limits the permissible amount of a single large loan by the bank as well as the sum of a bank's large loans.<sup>77</sup> Three conditions must be met as of the close of each business day: (1) the difference between a bank's assets and liabilities (as specified) denominated in foreign currency or precious metals may not exceed 21% of a bank's liable capital; (2) certain specified interest risks arising from interest rate futures and interest rate options may not exceed 14% of a bank's liable capital; and, (3) risks determined by the sum of the difference between delivery claims and delivery obligations arising under forward and option contracts involving price risks other than interest rate risks — provided that these contracts do not hedge the price risk posed by a portfolio of instruments of the same type — may not exceed 7% of a bank's liable capital.<sup>78</sup> These ratios of risk positions are known as Principle Ia (*Grundsatz Ia*). Because the 1993 Amendments to the KWG expanded the definition of liable capital in compliance with the Own Funds Directive,<sup>79</sup> the percentage figures have been reduced recently to the following: for (1) from 30% to 21%; for (2) from 20% to 14%; and, for (3) from 10% to 7%.<sup>80</sup>

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panying notes 27-36.

77. KWG, *supra* note 20, § 13. For a discussion of section 13, see *supra* text accompanying notes 36-40.

78. Grundsätze über das Eigenkapital und die Liquidität der Kreditinstitute - Bekanntmachung Nr. 1/69 des Bundesaufsichtsamts für das Kreditwesen [Announcement Concerning the Principles on Capital and Liquidity of Banks] 1969 Bundesanzeiger [Official Gazette, hereinafter BAnz no. 17] as amended in 1974 and 1983, (F.R.G.), [hereinafter Bekanntmachung No. 1/69]. See Bauer, *Regulation in Germany*, *supra* note 21, § 13.15, at 13-23.

Principle Ia was promulgated after the failure of Bankhaus Herstatt in 1974 to limit the risks of banks from open positions in foreign currency and precious metals. It has been revised to extend the scope beyond such positions to include risk positions arising from derivative products.

79. See *supra* note 53. See also *supra* text accompanying notes 64-75.

80. The Supervisory Authority has promulgated an amendment to Bekanntmachung No. 1/69, *supra* note 78, to reduce the percentage figures as indicated in the text. BAnz No. 44 of Dec. 31, 1992. Bekanntmachung über die Änderung und Ergänzung der Grundsätze über das Eigenkapital und die Liquidität der Kreditinstitute (Release to amend Bekanntmachung No. 1/69) [hereinafter Amendment to Bekanntmachung No. 1/69].

See Memorandum of the Bundesaufsichtsamt für das Kreditwesen, *Erläuterungen zur Bekanntmachung über die Änderung und Ergänzung der Grundsätze über das Eigenkapital und die Liquidität der Kreditinstitute* (Explanations relating to the Release to amend Bekanntmachung No. 1/69) 1992, at 33 [hereinafter Explanations]. A cover letter of the Supervisory Authority to the Amendment to Bekanntmachung No. 1/69 and to the Explanations, dated Dec. 29, 1992 (No. I 7-4216-1/91), stated that banks for the first time on June 30, 1993 must report on compliance with the new Principle I, see *infra* notes 84-87, and revised Principle Ia.

Banks must invest their funds in such a way that adequate solvency is assured at all times.<sup>81</sup> The aggregate amount of long-term loans — loans having an original term of four or more years — and investments must not exceed the aggregate amount of a bank's capital, long-term liabilities — liabilities having an original term of four or more years — and specified percentages of certain other liabilities. This requirement is known as Principle II (*Grundsatz II*).<sup>82</sup> The aggregate amount of a bank's short-term and medium-term loans and investments must not exceed the aggregate amount of its short-term and medium-term liabilities and specified percentages of certain other liabilities. This requirement is known as Principle III (*Grundsatz III*).<sup>83</sup>

The concept that liable capital is the basis for the volume of a bank's activities is an old concept of German bank regulation. Until December 31, 1992, Principle I (*Grundsatz I*) required that the aggregate amount of all of a bank's risk assets must not exceed eighteen times its liable capital.<sup>84</sup> As said above, the 1993 Amendments to the KWG transformed into German law the Own Funds Directive and its definition of liable capital or — as the Directive calls it — the own funds. In 1993 the corollary to the Own Funds Directive, the Solvency Ratio Directive<sup>85</sup> of the EC, and its concept of risk-based capital adequacy, which is based on the relationship between a bank's capital and the banking risk, has been transformed into German law by way of regulation of the Supervisory Authority promulgated under section 10 of the KWG.<sup>86</sup> This regulation creates a new Principle I which requires a solvency ratio of liable capital to risk-adjusted assets and certain off-balance-sheet items of at least 8%. The solvency ratio is computed according to the following formula:

$$\text{Solvency ratio} = \frac{\text{liable funds}}{\text{risk-adjusted assets and off-balance-sheet items}}$$

The existing rule which requires that assets of a bank do not exceed eighteen times its liable capital has been superseded.<sup>87</sup>

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81. KWG, *supra* note 20, § 11.

82. Bekanntmachung No. 1/69, *supra* note 78.

83. Bekanntmachung No. 1/69, *supra* note 78.

84. Bekanntmachung No. 1/69, *supra* note 78.

85. See *supra* note 53.

86. See Amendment to Bekanntmachung No. 1/69, *supra* note 79.

87. Amendment to Bekanntmachung No. 1/69, *supra* note 79. See Gruson & Feur-

Furthermore, the sum of most reserves and provisions that may be added to liable capital,<sup>88</sup> capital paid against issue of participation rights (*Genussrechte*),<sup>89</sup> and subordinated debt<sup>90</sup> may not exceed the amount of core capital (*Kernkapital*).<sup>91</sup> Subordinated debt may not exceed 50% of core capital.<sup>92</sup>

#### D. Reserve Requirements - - -

Based on section 16 of the Bundesbank Act,<sup>93</sup> the German Federal Bank may require banks to hold a specific percentage of their liabilities arising from deposits or from short- and medium-term borrowing in non-interest-bearing accounts with the German Federal Bank. Within certain limits, the German Federal Bank may set the percentages at different levels. The Minimum Reserves Order<sup>94</sup> issued by the German Federal Bank sets out the details of the reserve requirements, the kinds of liabilities for which minimum reserves must be maintained, and the balances to be held in the accounts. The minimum reserve system is intended to give the German Federal Bank a flexible and effective instrument of liquidity policy.<sup>95</sup> All banks in Germany are, in principle, obliged to maintain minimum reserves. To ensure compliance with the minimum reserves regulation, banks subject to reserve requirements are monitored by the state branches of the German Federal Bank and the accuracy of their reserve reports is checked by inspectors of the German Federal Bank.<sup>96</sup>

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ing, *supra* note 27, at 28-31.

88. See *supra* note 66.

89. See *supra* note 71.

90. See *supra* note 70.

91. KWG, 1993 Amendments, *supra* note 20, § 10(6b). Core capital is defined in KWG, 1993 Amendments, *supra* note 20, § 10(4a), and consists essentially of paid-in capital, retained earnings, and certain reserves, less losses and certain intangible assets.

92. KWG, 1993 Amendments, *supra* note 20, § 10(6b). See also Gruson & Feuring, *supra* note 27, at 32.

93. Gesetz über die Deutsche Bundesbank 1957 BGBl I 745 (F.R.G.) [hereinafter Bundesbank Act], as amended most recently by the Vierte Gesetz zur Änderung des Bundesbankgesetzes (Fourth Law amending the Bundesbank Act) 1992 BGBl I 1287 (F.R.G.).

94. Anweisung der Deutschen Bundesbank über Mindestreserven (AMR) 1983 BAnz. Nos. 21 and 27, as amended (F.R.G.).

95. See Bundesbank Act, *supra* note 93, § 16.

96. See Bauer, *Regulation in Germany*, *supra* note 21, § 13.22, at 13-30 to 13-32.

### E. Deposit Protection

Finally, it must be mentioned that Germany has no government-organized deposit insurance system. Nevertheless, the banking industry has organized its own private deposit protection funds. Private sector commercial banks, credit institutions organized under public law, and credit co-operative institutions each have their own system of deposit protection. The private commercial banks participate nearly without exceptions in a fund that covers all liabilities to creditors up to 30% of the liable capital.<sup>97</sup> For public law credit institutions, the deposit protection system is organized as a mutual system consisting of twelve regional funds for the mutual financial assistance of the savings banks on a regional basis (*Sparkassenstützungsfonds*) and a separate fund (*Sicherungsreserve*) for the mutual assistance of all *Landesbanken*. These thirteen funds are interrelated so that if any one fund has exhausted its resources, the other funds will be used to make up any deficiency. Although voluntary, participation in these funds is favorable for banks because non-participants must inform their non-bank customers accordingly.<sup>98</sup> Virtually all deposit-taking banks belong to one of the deposit protection funds set up by the banking associations.<sup>99</sup>

## VI. THE SUPERVISION OF BANKS IN GERMANY

The original KWG of 1934 subjected banks to the supervision of a newly established supervisory authority at the *Reichsbank*.<sup>100</sup> In the early years of the Federal Republic of Germany the supervision of banking was in the hands of the German states, but in 1962 the supervisory authority over banks finally was given to the Supervisory Authority.<sup>101</sup> The Supervisory Authority must carry out the bank supervision in close cooperation with the German Federal Bank, which is the German central

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97. See BANK-LEXIKON, *supra* note 5, at 686.

98. KWG, 1993 Amendments, *supra* note 20, § 23a.

99. For a discussion of the German deposit insurance system, see FEDERATION BANCAIRE DE LA COMMUNAUTE EUROPEENNE, DEPOSIT GUARANTEE SCHEMES OF THE COMMERCIAL BANKS IN MAJOR COUNTRIES (Brussels 1991). For a background on EEC initiatives relating to deposit insurance, see Recommendation Concerning the Introduction of Deposit Guaranties Schemes, 87/63, 1987 O.J. (L 33) 16, and Gruson & Feuring, *supra* note 27, at 36-37.

100. See generally Kreditwesengesetz of 1934, § 30 (1934).

101. Bundesaufsichtsamt für das Kreditwesen, established by the Kreditwesengesetz of 1962. See KWG, *supra* note 20, §§ 5-9.

bank.<sup>102</sup> The Supervisory Authority is an independent federal agency reporting to the Ministry of Finance.<sup>103</sup> The functions of the Supervisory Authority and the German Federal Bank are clearly divided: The authority to issue administrative acts binding on banks is vested only in the Supervisory Authority, whereas the German Federal Bank has no enforcement power in the field of bank regulation and bank supervision.<sup>104</sup> The Supervisory Authority, however, must consult with the German Federal Bank before it issues general regulations, and if the regulations affect the functions of the German Federal Bank (such as in the case of regulations concerning capital and liquidity), the consent of the German Federal Bank is required.<sup>105</sup> Furthermore, the German Federal Bank is charged with collecting and analyzing the periodic reports of the banks.<sup>106</sup> Each institution informs the other of all observations and findings that may be of relevance for the performance of their respective functions.<sup>107</sup>

All banks in Germany must file with the Supervisory Authority and/or with the German Federal Bank immediate notice of certain events and certain monthly, quarterly, and annual reports. The details of the reporting requirements are set forth in several regulations.<sup>108</sup> For instance, the reports cover the following: information about organizational changes;<sup>109</sup> the extension of large loans;<sup>110</sup> the extension of certain credits to the bank's directors, officers, and employees;<sup>111</sup> the acquisition or

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102. KWG, *supra* note 20, § 7. The Deutsche Bundesbank was established as Germany's central bank and bank of issue in 1957 by the Bundesbank Act. See *supra* note 93.

103. KWG, *supra* note 20, § 5; see Bauer, *Regulation in Germany*, *supra* note 21, § 13.05, at 13-8.

104. See Bauer, *Regulation in Germany*, *supra* note 21, § 13.05, at 13-9.

105. KWG, *supra* note 20, § 1(1) (consultation) & § 10(1) (consent). See Bauer, *Regulation in Germany*, *supra* note 21, § 13.05, at 13-10.

106. Bauer, *Regulation in Germany*, *supra* note 21, § 13.05, at 13-10.

107. KWG, *supra* note 20, § 7(1). Bauer, *Regulation in Germany*, *supra* note 21, § 13.05, at 13.10.

108. See, e.g., Verordnung über die Anzeigen und die Vorlage von Unterlagen nach dem Gesetz über das Kreditwesen, 1985 BGBl I 1716 (F.R.G.) [hereinafter Reporting Regulation]; Verordnung über die Befreiung von bestimmten Pflichten nach dem Gesetz über das Kreditwesen, 1985 BGBl I 1713 (F.R.G.); Verordnung über die Einreichung quotal zusammengefaßter Monatsausweise nach dem Gesetz über das Kreditwesen (Monatsausweisverordnung), 1985 BGBl I 2501 (F.R.G.). See Bauer, *Regulation in Germany*, *supra* note 21, § 13.18, at 13-25 to 13-26.

109. KWG, *supra* note 20, § 24; Reporting Regulation, *supra* note 108, § 8.

110. KWG, *supra* note 20, §§ 13-13(a); Reporting Regulation, *supra* note 108, §§ 3 & 4.

111. KWG, *supra* note 20, §§ 15, 16; Reporting Regulation, *supra* note 108, §§ 6 &

disposition of more than 10% of the equity of another company or certain changes in the amount of such equity investments;<sup>112</sup> balance sheets;<sup>113</sup> compliance statements with regard to capital and liquidity (Principles I, Ia, II and III);<sup>114</sup> cross-border money transfers;<sup>115</sup> foreign lending;<sup>116</sup> and, statements listing outstanding loans exceeding DM 1,000,000 (DM 3,000,000 beginning July 1, 1993).<sup>117</sup>

In order to maintain compliance with the banking laws, the Supervisory Authority may, among other things, at any time request information from, and conduct examinations of, a bank.<sup>118</sup> Since the Supervisory Authority does not have a staff of examiners, it will normally delegate the responsibility of inspection to auditing firms or the German Federal Bank.<sup>119</sup> The Supervisory Authority may call and attend meetings of a bank's supervisory board and order or prohibit certain actions in cases where a bank's liable capital or liquidity is insufficient or where the bank might not be able to perform its obligations to creditors.<sup>120</sup> It may close a bank or withdraw a bank's banking license.<sup>121</sup>

If one compares the regulation and supervision of German banks with the regulation and supervision of banks in the United States, one must conclude that the German system avoids some of the difficulties of the United States system. The following are some of the more obvious advantages of the German system:

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112. KWG, *supra* note 20, § 24(1), No. 3 & § 15(1), sentence 1, No. 9; Reporting Regulation, *supra* note 108, § 8.

113. KWG, *supra* note 20, § 25 (monthly information) & § 26 (annual financial information); Reporting Regulation, *supra* note 108, § 12.

114. See Letter from the Supervisory Authority of Dec. 29, 1992 (No. I7-4216-1/91); Bauer, *Regulation in Germany*, *supra* note 21, § 13.18, at 13-25. See also *supra* notes 78-84 and accompanying text.

115. See *Aussenwirtschaftsgesetz* (Foreign Trade Law), 1961 BGBl. I 481, as amended (F.R.G.); *Aussenwirtschaftsverordnung* (Foreign Trade Regulation), 1986 BGBl. I 2671 (F.R.G.), as amended, §§ 59-69.

116. *Verordnung über Angaben zu den Krediten an ausländische Kreditnehmer nach dem Gesetz über das Kreditwesen (Länderrisikoverordnung)* (Country Risk Regulation), 1985 BGBl. I 2497 (F.R.G.).

117. KWG, *supra* note 20, § 14(1) (requiring quarterly reports on outstanding loans of DM one million or more) was amended by the KWG, 1993 Amendments to increase the amount to DM three million. This increase becomes effective on July 1, 1993. KWG, 1993 Amendments, *supra* note 20, art. 9. See Reporting Regulation, *supra* note 108, § 5.

118. KWG, *supra* note 20, §§ 44, 44a.

119. See Bauer, *Regulation in Germany*, *supra* note 21, § 13.21, at 13-29.

120. KWG, *supra* note 20, §§ 45, 46.

121. KWG, *supra* note 20, §§ 46-51, 54-60.



(1) In Germany, there are no regulators with overlapping jurisdictions; neither the power of state and federal regulators<sup>122</sup> nor the powers of various federal agencies are duplicative. The authorities of the Supervisory Agency and the German Federal Bank are clearly defined.

(2) There are substantially fewer laws and regulations in Germany because Germany does not impose on banks the numerous restrictions on activities under which United States banks have to live and, consequently, the German regulators do not have to engage in the cumbersome procedures of granting exemptions from such prohibitions.

(3) Germany has avoided the problems created by the United States system of a governmental deposit insurance.<sup>123</sup>

#### VII. POTENTIAL PROBLEMS OF UNIVERSAL BANKING<sup>4</sup>

The advantages of the universal banking system are well known and need not be discussed here in detail. There are three significant advantages: (1) economies of scope and scale if a bank can offer and sell all financial services, such as consumer credit and life insurance; (2) decrease in cost of supervision and regulation; and, (3) alternative revenue sources for the bank and a corresponding reduction of economic risk.<sup>124</sup> In spite of these indisputable advantages, the universal banking system as it exists in Germany today is far from being undisputed. Among a variety of issues being discussed,<sup>125</sup> three dangers arising from the universal banking system should be specifically mentioned: (1) dangers to the bank itself and consequently to its depositors; (2) the possible abuse of information by the bank; and (3) dangers to competition. None of these three concerns involves all three elements of the German universal banking system — the

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122. See Michael Gruson, *Foreign Banks Are No Longer Welcome in the United States*, 10 No. 23 BANKING POL'Y REP. 5 (Dec. 2, 1991); Michael Gruson, *Neue Beschränkungen für ausländische Banken in den USA*, 46 ZEITSCHRIFT FÜR WIRTSCHAFTS- UND BANKRECHT 1757, 1759 (1992).

123. See generally PETER J. WALLISON, *BACK FROM THE BRINK* (1990).

124. See Hans E. Büschgen, *The Universal Banking System in the Federal Republic of Germany*, 2 J. COMP. CORP. L. & SEC. REG. 1, 4-10 (1979); Eberhard Martini, *Hat das deutsche Universalbanksystem Zukunft*, 39 ÖSTERREICHISCHES BANK-ARCHIV 615 (1991).

125. See Hans-Jacob Krümmel, *German Universal Banking Scrutinized*, 4 J. BANKING & FIN. 33, 36-46 (1980); Theodor Baums, *Should Banks own Industrial Firms?* 5 REVUE DE LA BANQUE/BANK-EN FINANCIEREZEN 249, 253-54 (1992); GEORGE J. BENSTON, *THE SEPARATION OF COMMERCIAL AND INVESTMENT BANKING* 179-214 (1990).

ability of a bank to engage in commercial and investment banking under the same roof, the ability of banks to own shares of non-banking corporations, and the right of commercial enterprises to own banks.

A. *Dangers to the Bank and its Depositors*

Dangers to the bank itself and, consequently, to its depositors are obviously connected with the first aspect of the German universal banking system, commercial and investment banking under one roof.<sup>126</sup> But they can also arise from the second aspect, the permanent holding of shares of non-banking corporations:<sup>127</sup> First, shares held by the bank must be considered to be illiquid assets that, in case of a "run" when the bank needs money, probably have to be sold below their real value. Furthermore, the possible loss of value of the shares held by the bank can lead to a diminution of the bank's assets and, consequently, of the security of deposits. Besides, if a corporation runs into difficulties and the shares are held by a bank, then the bank may be tempted to grant risky credits to that corporation in order to secure the value of its shares.<sup>128</sup>

Nevertheless, it is doubtful whether these dangers really justify a general prohibition of shareholding, dealing in securities, and underwriting by commercial banks as is the case in the United States under the Glass-Steagall Act.<sup>129</sup> In Germany the problem is solved by the following: (1) restricting the amount of illiquid assets of the bank, which must not exceed in the aggregate the liable capital of the bank;<sup>130</sup> (2) limiting each significant investment to 15% of the bank's liable capital and all significant investments to 60% of the bank's liable capital;<sup>131</sup> (3) restricting the amounts of a bank's large loans (i.e., loans extended to or investments made in any one borrower or consolidated group of borrowers that, in the aggregate, exceed 15% of a bank's liable capital) to eight times the bank's liable capital and each single

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126. See More, Note, *supra* note 3, at 444-49.

127. See THEODOR BAUMS, VERBINDUNGEN VON BANKEN UND UNTERNEHMEN IM AMERIKANISCHEN WIRTSCHAFTSRECHT 51 (1992).

128. Michael Gruson, *Non-Banking Activities of Foreign Banks Operating in the United States*, in REGULATION OF FOREIGN BANKS, UNITED STATES AND INTERNATIONAL § 9.01, at 9-3 (Michael Gruson and Ralph Reisner eds., 1991).

129. See BAUMS, *supra* note 127, at 12, 27.

130. KWG, *supra* note 20, § 12. See *supra* note 27 and accompanying text.

131. KWG, 1993 Amendments, *supra* note 20, § 12(5). See *supra* notes 28-36 and accompanying text.

large loan to 50% of a bank's liable capital;<sup>132</sup> and, (4) requiring prompt reports to the Supervisory Authority and the German Federal Bank of the acquisition or disposition of an investment in another company in excess of 10% of the equity of such company and of changes in such investments if such change involves more than 5% of the equity of such company.<sup>133</sup> This system is flexible because it is based on the capitalization of the bank and it is generally considered to be sufficient. Even after the two recent bank collapses — Herstatt Bank in 1974 and Schroeder, Muenchmeyer, Hengst & Co. in 1983 — the German legislature and the German banking regulators did not deem it necessary to change the whole system. The Supervisory Authority, however, tightened existing supervisory regulations.<sup>134</sup>

#### *B. The Possible Abuse of Information*

A second argument that could be raised against the German universal banking system concerns the possible abuse of information. This danger concerns primarily the first element of that system — the ability to practice commercial and investment banking under one roof. For example, a bank could be tempted to use information it obtained in the course of a credit relationship in order to buy or sell shares of the corporation concerned. But an abuse of information can also happen in connection with the second aspect — the ability of banks to be permanent shareholders of non-banking corporations. For example, a bank could hand over information to one of its non-banking subsidiaries that it has acquired as creditor of a competing corporation.<sup>135</sup> Furthermore, information the bank receives as shareholder could, in the case of a crisis of the corporation concerned, be used by the bank in order to react faster than other competing creditors.

It must be admitted that the dangers of an abuse of information can probably not be excluded completely by institutional precautions such as physical and personal separation of commercial and investment banking — “Chinese Walls.”<sup>136</sup> Nevertheless, the abusing bank may incur civil liabilities and, much more

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132. KWG, *supra* note 20, § 13. See *supra* notes 37-40 and accompanying text.

133. KWG, *supra* note 20, § 24(1) & (3). See KWG, *supra* note 20, § 15(1)(9).

134. See *supra* notes 78-79 and accompanying text.

135. See BAUMS, *supra* note 127, at 71.

136. See BAUMS, *supra* note 127, at 72.

importantly, risk its reputation if it abuses confidential information. It seems that this risk by itself is quite effective in discouraging banks from abusing information. The danger that a bank may abuse inside information is not unique for universal banks. It also exists in the case of the United States banking system,<sup>137</sup> and the regulatory and legislative approaches to dealing with this problem are the same in both systems.

### C. *Dangers to Competition*

The third argument that could be raised against the universal banking system relates to the possible dangers to competition caused by that system. These dangers become relevant only in connection with the second aspect of universal banking — the ability of banks to be permanent shareholders of non-banking corporations. It is in this context that the discussion about the pros and cons of the universal banking system has become particularly controversial in Germany. Thus, the Commission Against Monopolies, an independent panel of experts that has only advisory powers, has repeatedly proposed to restrict the amount of shares that a bank is allowed to hold to 5% of the total amount of shares of a corporation.<sup>138</sup>

In fact, one could think of several situations where banks as shareholders of non-banking corporations might be tempted to apply practices that obstruct free competition. For example, the bank could discriminate against competitors of its non-banking corporation by offering its corporation more favorable credit conditions.<sup>139</sup> It could try to conclude "tie-in" agreements with its customers in order to oblige them to enter into business rela-

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137. See Larry L. Varn, *The Multi-Service Securities Firm and the Chinese Wall: A New Look in the Light of the Federal Securities Code*, 63 *NEB. L. REV.* 197 (1984); Leo Herzel & Dale E. Colling, *The Chinese Wall and Conflict of Interest in Banks*, 34 *BUS. LAW* 73 (1978); Ralph F. Huck, *The Fatal Lure of the "Impermeable Chinese Wall"*, 94 *BANKING L.J.* 100 (1977); Carlos E. Mandez-Peñate, *The Bank "Chinese Wall": Resolving and Contending with Conflicts of Duties*, 93 *BANKING L.J.* 674 (1976); Martin Lipton & Robert B. Mazur, *The Chinese Wall Solution to the Conflict Problems of Securities Firms*, 50 *N.Y.U. L. REV.* 459 (1975); Martin E. Lybecker, *Regulation of Bank Trust Department Investment Activities*, 82 *YALE L.J.* 977 (1973); Edward S. Herman & Carl F. Safanda, *The Commercial Bank Trust Department and the "Wall"*, 14 *B.C. INDUS. & COMM. L. REV.* 21 (1972).

138. See *Mehr Wettbewerb ist möglich*, in Monopolkommission, *Hauptgutachten* 1973/1975 296 (2d ed. 1977); Monopolkommission, *Sondergutachten* 18, *Zusammenschlußvorhaben der Daimler-Benz AG mit der Messerschmitt-Bölkow-Blohm GmbH*, 145 (1st ed. 1989).

139. See Gruson, *supra* note 128.

tions only with its corporation and not with the competitors of that corporation.<sup>140</sup> The bank could also be tempted to practice "favoritism," by offering the customers of its corporation more favorable conditions than the customers of competing corporations can get. Furthermore, it could try to prevent its corporation from entering into business relationships with other banks or investment banks. Finally, the situation could arise where a bank holds shares of corporations competing with each other and thus might be tempted to use its influence in order to reduce competition between these corporations. Those dangers seem to be even more relevant if one takes into consideration that the influence German banks have as shareholders is complemented by the voting power conferred to them by the voting proxies they exercise on behalf of their customers.<sup>141</sup>

Under German law, these problems are dealt with by the application of general competition law and especially the anti-trust law, not by the banking law. While, for example, a special statute in the United States prohibits banks from entering into tie-in agreements,<sup>142</sup> such specific regulations do not exist in Germany. But this does not mean that the more general approach of German law must necessarily be less effective. In serious cases of abuse, the German Civil Code permits courts to declare an agreement void if it is contrary to public policy.<sup>143</sup> One can also argue that the general provisions of German law enable the authorities to react with the necessary flexibility in order to strike a reasonable balance between the interests concerned, *i.e.*, to maintain free competition, on the one hand, and to have banks that are strong enough to deserve confidence and to compete internationally on the other. In this context, the possible hazards of the German universal banking system must be seen in connection with the advantages of such a system; it enables banks to diversify and thus to respond flexibly to changing economic situations.<sup>144</sup>

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140. See BAUMS, *supra* note 127, at 67.

141. See Theodor Baums, *Corporate Governance in Germany: The Role of the Banks*, 40 AM. J. COMP. L. 503 (1992).

142. Bank Holding Company Amendment § 106(b) (1970) (current version at 12 U.S.C. § 1972 (1992)).

143. Bürgerliches Gesetzbuch [Civil Code] BGB § 138 (F.R.G.).

144. Martini, *supra* note 124, at 619.

## VIII. CONCLUSION

The German government is presently working on legal reforms with the intention to make Germany one of the central markets for financial services in a common European market. This, together with the birth of a single EEC-wide banking market on January 1, 1993, will create for banks in Germany a new, far more competitive environment. It would seem that a universal banking system is most suitable to master the challenges following from structural changes brought by internationalization, globalization, financial innovations, and changes in customer needs. On the other hand, there is the need for the protection of the depositors of the bank and the safety of the banking system and its functions. Only a banking system that balances the opportunities of a bank to diversify risks and to have income from different sources with effective, comprehensive, and consolidated banking supervision will be the banking system of the future. The banking system in Germany has a chance to meet this test.